San Diego City Attorney
MICHAEL J. AGUIRRE

NEWS RELEASE

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PENSION OVERPAYMENTS IN VIOLATION OF IRS CODE NOT REFLECTED IN CITY'S CERTIFIED 2005 FINANCIAL STATEMENTS; CITY ATTORNEY URGES CORRECTION TO COMPLY WITH FEDERAL SECURITIES DISCLOSURE LAWS

San Diego, CA—More than $8 million in pension overpayments to 102 retired employees, in violation of Internal Revenue Service regulations, was not disclosed in the City's 2005 Financial Statement which was certified in October by the City's outside auditor, Macias, Gini & O'Connell (Macias Gini). City Attorney Michael Aguirre today called on the auditor to re-issue corrected financial statements for 2005.

"We are under a 2006 federal Order by the U.S. Securities and Exchange Commission to ensure that our financial statements are accurate in all material respects," said City Attorney Aguirre. "We cannot allow the 2005 financial statements to go forward absent known information."

In addition to the City of San Diego, Macias Gini is retained by the San Diego City Employees' Retirement System (SDCERS). In June, 2007, Macias Gini issued SDCERS' 2005 financial statement.

In a letter to Macias, Gini & O'Connell sent last Friday, November 30, 2007, Aguirre stated:

As you are aware, on November 14, 2006, the City entered into a cease-and-desist order with the Securities and Exchange Commission (Commission) related to violations of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with the offer and sale of municipal securities in 2002 and 2003, and other related public financial disclosures. The Commission concluded that the "City's public disclosures in the preliminary official statements and official statements for its 2002 and 2003 offerings, its 2003 continuing disclosures, and presentations to the rating agencies failed to disclose material information regarding the City's current funding of its pension and retiree health care obligations, the City's future pension and retiree health care obligations, and the City's ability to pay those future obligations." The Commission further concluded that " [t]he the City, through its officials, acted with scienter."

On August 22, 2007, SDCERS' tax counsel, Ice Miller LLP, advised IRS officials that "102 participants have at some point in their retirement exceeded the 415 limit." The Ice Miller firm put the "total excess benefits" at $8,160,027.

(more)

The tax qualified status of the City's pension plan could be lost if pension officials pay pension benefits above those allowed by Internal Revenue Code § 415. Ice Miller attorneys have advised SDCERS officials that retaining "qualified" status is needed so that City employees do not have to pay taxes on contributions and investment returns earned by the pension fund.

In March 2001, the City Council created an additional pension program called the "Preservation of Benefit Plan" (POB) which was designed to pay the excess benefits from the City's General Fund—the same fund that is used to pay for City services such as public safety salaries, street maintenance, libraries and parks. However, the City only began to budget for POB payments in FY 2008.

The San Diego City Attorney has obtained from SDCERS the identities of the 102 plan participants who have received excess pension benefits. Included are former City Attorney Casey Gwinn who received $213,000 in excess pension benefits between 2005 and 2007, former Deputy City Manager Bruce Herring who has received $201,306, and former Assistant Police Chief Keith Enerson who has received $376,830.

In addition to their regular annual retirement payment, one City retiree has received over $800,000 in excess pension benefits over a 7-year period.

According to the City Attorney, Gwinn, Herring and Enerson were key players in the employee pension debacle. The City Attorney's office under Gwinn was in charge of providing legal advice on pension issues, while Herring, a former member of the SDCERS Board, helped to negotiate the increase in pension benefits for reduced City contributions deals in 1996 and 2002 that led to a U.S. Securities and Exchange Commission fraud action against the City and criminal charges being filed by the U.S. Attorney's Office and District Attorney's Office against several former pension officials. Enerson, the former president of the SDCERS Board, was one of three architects of Managers Proposal 1--the increased benefits for reduced contributions agreement that started the pension crisis.

In addition, in a November 13, 2007 letter, Aguirre requested that Macias Gini conduct an analysis to 1) determine whether the Preservation of Benefits Plan was properly established by the City in 2001, 2) determine whether SDCERS' funding of excess benefits from pension system's assets could disqualify SDCERS as a "qualified plan" within the meaning of Internal Revenue Code, and 3) amend the City's FY 05 financial statement to include related disclosures regarding the payment of excess benefits.

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